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C O N F I D E N T I A L SECTION 01 OF 02 MOSCOW 012587

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DEPT FOR EUR/RUS WARLICK, HOLMAN, AND GUHA

DEPT FOR EB/ESC/IEC GALLOGLY AND GARVERICK

DOE FOR HARBERT/EKIMOFF/PISCITELLI

DOC FOR 4231/IEP/EUR/JBROUGH

NSC FOR GRAHAM AND MCKIBBEN

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TAGS: [EPET](#) [ENRG](#) [ECON](#) [PREL](#) [RS](#)

SUBJECT: RUSSIAN ENERGY: CRUNCH TIME FOR CPC

REF: A. MOSCOW 12442

[1](#)B. MOSCOW 10777

Classified By: Amb. William J. Burns. Reasons 1.4 (b/d).

[11.](#) (C) Summary: On November 20, the Ambassador met with Chevron Vice Chairman Peter Robertson and head of Chevron's Russian operations, Ian MacDonald. The conversation centered on CPC expansion but included brief discussions of the Burgas-Alexandroupolis bypass pipeline (BAP), and the on-going tax case against CPC (Ref B). There is real concern that a last-minute GOR demand for higher transport tariffs could scuttle plans for a signing of an MOU on CPC expansion next week. If that happens, Chevron and other Kazakh-based oil shippers may intensify their search for alternate export routes. MacDonald was upbeat that BAP would be built. He is resigned that CPC will lose an appeal on its tax case next week and will need to take it to the Court of Cassation next year. End Summary.

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The MOU is Done, But...

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[12.](#) (C) On CPC, MacDonald said that the text of an MOU on the terms of expansion has been agreed by all (including the GOR) with the exception of a couple minor governance issues (the size of the Board and the definition of a quorum). The MOU includes agreed language on all economic matters, including tariffs. MacDonald said that next week's seniors' meeting (chaired by the Russian and Kazakh energy ministers but yet to be confirmed) could be an MOU signing ceremony.

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A Wrench in the Works

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[13.](#) (C) However, Robertson and MacDonald are worried that the GOR will insist on raising tariffs above the agreed-upon level just prior to next week's meeting. They said that the letter Chevron received from Energy Minister Viktor Khristenko (Ref A) and public comments last Friday from Sergey Oganesyan, head of the Energy Ministry's Federal Energy Agency (FEA), both hint at a GOR desire for higher tariffs designed to accelerate the retirement of debt and thus profits payable to the GOR. While these messages could just be trial balloons, they could not rule out that Russia would come in with such a last-minute demand and predicted that, if it did, it could be a deal-breaker. Moreover, Kazakhstan's potential reaction to such a late tactic is unknown. Since ultimately higher tariffs come out of

Kazakhstan's hide, the reaction should be negative. However, if the Kazakhs and Russians have agreed to higher tariffs ahead of next week's meeting, Chevron and all but one of the other shareholders would probably go along.

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Bypasses and Taxes

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14. (C) When the Ambassador asked about progress on the BAP, MacDonald said that there have been bumps along the way but stated emphatically that "Burgas-Alexandroupolis will happen." However, he was considerably less sanguine that CPC would win an appeal to have overturned a back-tax claim imposed in September. He told us that he was certain CPC would lose at the Court of Appeals early next week and that it would undoubtedly be forced to take the case to the Court of Cassation in Spring 2007. MacDonald admitted that if the tax case were ultimately lost, it would take a tariff at the level the GOR is floating (USD 38/ton) to make CPC profitable.

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Comment

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15. (C) Clearly, any tariff increase above what is currently in the MOU would dash any hope that the document will be signed at next week's meeting. Such a demand from the Russian side would not only show bad faith negotiating tactics (nothing new) but could be the last straw for some of the producing companies. Echoing what MacDonald has told us many times, Robertson noted that Chevron is thinking more seriously about alternate routes for oil from Kazakhstan's Tengiz field, including the Baku-Tbilisi-Ceyhan (BTC) pipeline. Oil from Kazakhstan will reach world markets

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somehow. The question the Russians can help answer over the coming weeks will be whether CPC gets a slice of that business -- thereby benefiting Russia directly -- or whether potential Russian hubris undermines that opportunity.

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